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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 6

D. W. McEACHERN, ADMINISTRATOR OF THE ESTATE OF S. C. McEACHERN, DECEASED,

Petitioner,

v.

J. T. ROSE, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF GEORGIA.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

REPLY BRIEF FOR PETITIONER.

W. A. SUTHERLAND,
JOSEPH B. BRENNAN,
Counsel for Petitioner.

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In view of certain admissions made in brief for respondent and the consequent narrowing of the issues involved, petitioner is taking the liberty of filing this reply brief. The discussion will follow the order of the respondent's brief.

Respondent's So-Called Equitable Defense.

In respondent's brief the Solicitor General abandons the defense of estoppel (Br. pp. 9-11 n.) and admits that there

is no defense of "strict recoupment" (Br. p. 17). He asserts that the defense is "in the nature of an equitable recoupment,"[1] and that under a general plea of *non assumpsit* he can show any facts which would deny the equity of petitioner's claim (Br. p. 17). This statement overlooks the fact that the Georgia practice, which must be followed under the Conformity Act,[2] does not recognize the plea of *non assumpsit;* and in an action of this kind the only defenses available without affirmative pleading are the non-receipt of the money sued for or its repayment. Georgia Code 1933, Secs. 81-306, 81-307; *Massee* v. *Stetson,* 27 Ga. App. 89; *Walker* v. *Kingston Supply Co.,* 18 Ga. App. 447. It is submitted that respondent's plea was one of estoppel pure and simple[3] and the evidence he tendered was inadmissible under the pleadings. If the evidence offered by respondent was properly excluded, of course petitioner was entitled to judgment.

In attempting to show the "inequity" of allowing petitioner to recover here, respondent claims that the income on which taxes were erroneously paid for 1929, 1930 and 1931, was the same income on which a tax should have been,

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[1] That is, "not the standard article to be marked by the standard label." See *Daube* v. *United States,* 289 U. S. 367, 371.

[2] 28 U. S. C. A. § 724.

[3] It is true that respondent's plea alleged that "it would be unconscionable for the plaintiff to be allowed any recovery from defendant." (R. 17, 20, 23.) However, the statement is based upon alleged circumstances which relate only to estoppel. The plea cannot have the faintest flavor of recoupment where it does not indicate the amount of the 1928 tax which the Government has lost. On the other hand, if the remaining elements of estoppel were present a lost tax of $10 for 1928 would be sufficient detriment to the Government to warrant the application of estoppel. Moreover, respondent's affirmative plea concludes with a claim of estoppel based upon what has gone before.

In the cases of *Stone* v. *White,* 301 U. S. 532, and *Bull* v. *United States,* 295 U. S. 247, the amounts of the taxes underpaid and overpaid, respectively, were distinctly set up in the pleadings.

but was not, paid for 1928. Even if the same income were involved[4] it will be apparent that there would be no equitable basis for denying recovery in this case.

Respondent's argument at its best amounts to this: Petitioner erroneously paid a tax on certain income as income for 1929, 1930 and 1931; petitioner should have paid a greater tax for 1928 on the same income; therefore the payments made were erroneous only because they were identified as taxes for the wrong year. The simple answer to that argument is that the amounts paid for 1930 and 1931[5] would be refundable even if they had been paid and received as taxes for 1928. This follows from the fact that at the time petitioner filed returns for 1930 and 1931, and at the time the taxes for those years were assessed and collected, the statute of limitations had run against assessment and collection for 1928.[6] Under Section 607 of the Revenue Act of 1928 (45 Stat. 791) any amounts collected as tax after the expiration of the limitation period are deemed overpayments and are refundable. Respondent, therefore, cannot properly say that the payments were erroneous *only* because they bore the wrong labels. Even if they had been labelled as 1928 taxes, they were erroneously paid and would constitute refundable overpayments.

Stated another way, respondent's argument is that it is inequitable for petitioner to recover a tax erroneously paid on certain income if the same income has escaped tax on a

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[4] While it should be immaterial for the decision of this case, the collections on the installment obligations received by petitioner in 1929, 1930 and 1931 are not the *same* income which respondent alleges was subject to tax in 1928 on the transmission at death of the said installment obligations. The transmission by death did give rise to taxable income to decedent in 1928 if Section 44(d) is applicable and constitutional; but there was no income on the collection of these obligations by petitioner except a very small amount the tax on which is not now in dispute.

[5] The only amount of 1929 taxes involved is the sum of $230.07.

[6] See petitioner's original brief, p. 30 n.

correct basis. The argument is unsound since it would serve to defeat any action to recover a tax collected after the statute of limitations had run. It is well established that such an action can be maintained although it may result in the taxpayer's recovery of a tax erroneously paid on income which has escaped tax on a correct basis. Even before Section 607 of the 1928 Act, this court allowed recovery in such a case. *Bowers* v. *New York & Albany Lighterage Co.*, 273 U. S. 346.[7] It is submitted that respondent has failed to point out any circumstance in the present case which would render it inequitable for petitioner to recover.

If the Government had been misled into not collecting the tax due for 1928 by anything contained in the returns filed for 1929, 1930, and 1931, and had proved such facts, a different situation might exist. Under such circumstances something in the nature of an estoppel might exist which would prevent a change of the positions taken in these returns. But there is not anywhere in the record the slightest evidence that anything in these returns had any effect whatever in influencing the Commissioner not to collect the taxes alleged to be due for 1928.

If in 1928 the petitioner had taken a position which if correct would require him to take the position he took in his returns for 1929, 1930, and 1931, it might be unfair to permit the petitioner to avoid the results of the position taken in 1928 by taking a position inconsistent with that required by his 1928 return after the statute of limitations has run against collection for that year. But we have no

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[7] The court below relied upon *Moses* v. *Macferlan*, 2 Burr. 1005, in which the court said that an action in assumpsit for money had and received could not be maintained to recover money paid after the statute of limitations had barred payment. Such a principle can have no application in a taxpayer's suit for refund, as this Court has made clear. In a case of that kind the parties are reversed, and the taxpayer is in substance and effect the defendant. See *Bull* v. *United States*, 295 U. S. 247, 260.

such situation here. The taxability or nontaxability of the unpaid installment obligations in the return of the decedent for the year of his death has no relation whatever to the income tax of decedent's estate. The decedent's estate is taxable only on the difference between the value at date of death of property or obligations received from decedent and the amount realized on their disposition or collection. This was the same before Section 44(d) was enacted and after and is the same whether Section 44(d) is constitutional and applicable or not.

The respondent apparently is seeking to establish the existence of some such special equities when on page 14 of his brief he says:

> "The showing by which Petitioner establishes that the income reported was not taxable in those years (1929, 1930 and 1931) discloses that the income was taxable in another year for which it was not reported."

This clearly is not so. In order to show that an excessive amount has been reported as income on the collection, by the estate, of choses in action acquired from the decedent, petitioner needs to show only that the reported amount exceeds the difference between the amount collected and the value of the choses at petitioner's death.

It is immaterial for the purpose of this showing how these obligations were treated in connection with decedent's income tax returns for 1924 or 1928. Whether the income taxes of decedent for either of those years were underpaid or overpaid has nothing to do with the determination of the income of the estate on the collection of these obligations. The only fact of importance is that the obligations became capital in the hands of the estate at their fair market value at the date of the death of the decedent and the Government collected an estate tax upon this basis. This and this alone is made the basis under the law for future determinations of income, and no error for or against the

decedent in the taxation of income to him can in any way affect the income tax computations of the estate.

The respondent relies upon three decisions of this Court as sustaining his position in this case, viz., *Stone* v. *White*, 301 U. S. 532; *Bull* v. *United States*, 295 U. S. 247; and *Lewis* v. *Reynolds*, 284 U. S. 281.

The case of *Lewis* v. *Reynolds* has no bearing upon the present case. It involved taxes for only a single year and the *taxes for that year* admittedly *had not been overpaid.* This Court in denying recovery had only to say, as it did:

> "An overpayment must appear before refund is authorized." 284 U. S., at 283.

The case of *Bull* v. *United States*, far from supporting the position of respondent, seems to support the position of petitioner. The *Bull* case held that an income tax against an estate and an estate tax could not be collected on the same item. Here an estate tax was paid on $80,714.25 out of the $90,000 collected by the estate in 1929, 1930 and 1931, and now the Government claims the right to retain income taxes erroneously paid on all except $1,500 of the $90,000 collected, even though on $80,714.25 of this sum a capital tax (the estate tax) has already been paid. This is exactly what the *Bull* case held could not be done.

The case of *Stone* v. *White, supra,* was discussed in petitioner's original brief. As was there pointed out, it is clearly distinguishable from the present case in several particulars. There a single error resulted in the overpayment by one taxpayer and underpayment by the other. A holding that one party was liable meant that the other was not, and *vice versa.* Here regardless of whether or not a tax was due in 1928 by decedent, clearly no tax was due for 1929, 1930 and 1931. The Commissioner in *Stone* v. *White* was excusable for his error. He was misled by court deci-

sions and could have protected himself legally only by the hardship of assessing both trustee and beneficiary. Here the Commissioner could not have been in any quandary because it was clear to anyone considering the matter that no tax was due for 1929, 1930 or 1931. While, under the modified opinion of this Court in that case, it appears that the taxes were not collected from the trustee before the statute ran against the beneficiary, the Commissioner, however, did *assess* the tax against the trustee before the statute ran against the beneficiary. Here the taxes collected for 1930 and 1931 were assessed and collected after the statute of limitations had run on 1928.[8] In fact, the statute had run even before the returns for these two years were filed. In *Stone* v. *White* the Court does not cut across taxable years and ignore the computations of income on a yearly basis which is an essential part of our present system of income taxation. A decision in respondent's favor here to a large extent must ignore the separation between different taxable years.

Here the respondent's defense amounts to no more than a showing that a tax upon certain income was not collected when it was due. The reason given for the failure to collect the tax is that the income tax return for the year did not show the receipt of this income. This reason, which lies behind the failure to collect a large part of the taxes upon which the statute of limitations runs, does not justify the respondent in failing to follow the express commands of Sections 607 and 609 of the Revenue Act of 1928 by retaining erroneous payments made in later years. The "abstract justice" upon which respondent attempts to justify his illegal retention of these payments would apply in any case where a tax is paid after the statute of limitations has run.

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[8] The foregoing distinction between this case and *Stone* v. *White* is the only distinction that does not apply as well to petitioner's claim for the 1929 overpayment as to overpayments for 1930 and 1931.

If respondent's position were sound, the Government in order to collect any barred tax for any year would have only to assert the liability in any open year on the basis of the inclusion in that year of the income on which tax had not been paid, and then, after the tax had been collected, the Government could defend against its repayment on the ground that it was paid on the same income in connection with which the taxpayer had failed to pay the proper tax in another year. Obviously this Court should not be asked so to hold.

The Unconstitutionality of Section 44(d)

Respondent attempts to support Section 44(d) against constitutional attack by urging that the section should be construed as taxing something other than what it says should be taxed. Section 44(d) provides in so many words that—

> "If an installment obligation is * * * transmitted * * * gain or loss shall result to the extent of the difference between the basis of the obligation and * * * the fair market value of the obligation at the time of such transmission."

Respondent claims, of course, that the section becomes operative when an installment obligation is transmitted by death, but he contends that:

> "This section does not and was not intended to tax any purported income arising from the transmission of the obligation at death." (Resp. Br., p. 22.)

In an effort to save the validity of Section 44(d), the respondent urges that it should be construed as taxing "the remaining unreported profit on the (installment) sale in the year in which the vendor disposes of the (installment) obligations by transmission by death or otherwise." (Resp.

Br., p. 21). It is submitted that the statute cannot be given any such construction.

This Court has made it plain that it will not by usurpation of the legislative function rewrite a statute and give it a meaning it certainly does not have in order to save it from unconstitutionality. In *Heiner* v. *Donnan*, 285 U. S. 312, this Court held invalid the provision of Section 302(c) of the Revenue Act of 1926, creating a conelusive presumption that a gift within two years of the donor's death was made in contemplation of death and was, therefore, subject to the estate tax. The Government attempted to support the provision as being in effect a tax on certain gifts *inter vivos*. In repudiating that contention, this Court said:

> "It is so apparent from a consideration of these features of the statute that Congress could not have had, even remotely, in mind the imposition of a gift tax, that to construe the provision in question as imposing such a tax is to disregard the plain language and the plain intent of the act. For this court to do so would be to enact a law under the pretense of construing one and thus pronounce itself guilty of a flagrant perversion of the judicial power." 285 U. S. at 331.

It is impossible to construe Section 44(d) as imposing a tax in the year of the seller's death on the unreported profit resulting from the installment sale. This was demonstrated in our original brief where we pointed out, *inter alia*, that the fair market value of the installment obligations outstanding at death, which is an essential element in a computation of gain under Section 44(d), can have nothing to do with the profit realized on the sale and on the collection of prior installments.

Respondent's brief admits that the "profit" taxable under Section 44(b) and (d) would be greater than the profit which could have been taxed to the seller under at

least two methods of computation. (Resp. Br., pp. 30, 31). But respondent urges that there is a third method of computation which if applied here would show the same taxable profit to the seller as is shown under Section 44(b) and (d). (Resp. Br., pp. 31, 32). The "third method" might be questioned as a proper measure of "income", within the meaning of the Sixteenth Amendment. The view that the earlier deferred payments contain a larger percentage of profit than the later ones does not fit in with the popular conception of income which limits the congressional power.[9]

But in any event, Section 44(d) does not undertake to apply this "third method". It may be that in some cases the results will be the same. It would seem that the amount taxable under the "third method" would equal the amount taxable under Section 44(b) and Section 44(d) together, only (1) if the assumed rate of discount remained constant from year to year and (2) if the payments received up to the seller's death are not too small to reflect the accumulated discount on the remaining payments.

In the computation set out in Appendix B of respondent's brief, the results under the "third method" and Section 44(b) and (d) are shown to be the same *only because a constant rate of discount is arbitrarily assumed and a figure is taken as representing the 1924 market value of the purchase money obligations which does not have anything to support it.* It cannot be assumed that the extent of discount reflected by the fair market value of the obligations outstanding at the seller's death in 1928 can be used to determine the fair market value of all deferred payments at the time of sale in 1924. There is more than the element of time in determining the value of such obligations. If the risk element is to be ignored, as respondent has ignored it, there

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[9] *Eisner* v. *Macomber*, 252 U. S. 189, 206; *United States* v. *Safety Car Heating and L. Co.*, 297 U. S. 88, 99.

would be no reason why the rate of discount here would differ from that on Treasury notes.

The risk element is variable in these cases. Security may become more or less valuable as maturity approaches. Here the stock which was sold was originally pledged to secure 90 per cent of the selling price,—leaving a small margin of security. At the seller's death, the same amount of stock secured only 50 per cent of the original selling price.

If the "third method" advanced by respondent can ever have a place in determining taxable income under the Sixteenth Amendment, it must be clear that such a method is not incorporated in Section 44(d). If the results are the same in any case under Section 44(b) and (d) as under that method, it is because by mere chance the discount reflecting the value of installment obligations at death is based on the same rate as the discount reflecting value at the date of sale.

Respondent suggests that petitioner's constitutional objections can be disposed of on the ground that the evidence does not show that the tax under Section 44(d) (stipulated to be $11,625) is any greater than the tax which might have been collected for 1924 (the year of sale) on the excess of cash and fair market value of deferred payments over the cost of the property sold. (Resp. Br., pp. 26, 27). There was, of course, no evidence as to the market value (if any) of the installment obligations in 1924; and it, therefore, does not appear what amount could have been taxed as gain in that year if the installment method had not been used. But that circumstance is of no importance. A tax on a fictitious "gain" in 1928 cannot be sustained on the ground that the taxpayer has failed to show that a tax could not have been imposed upon him in as great an amount in 1924. Respondent's argument could be just as logically applied to deny a refund of a tax collected on a stock dividend, on the ground that the taxpayer had the benefit of certain de-

ductions which Congress did not have to, but did, allow, and which, if disallowed, would result in the taxpayer's having paid a correct amount of tax.

As we have demonstrated, Section 44(d) does *not* undertake to tax the unreported portion of a profit that could have been taxed in earlier years, and the nature and extent of such profit is immaterial here.[10]

Respectfully submitted,

W. A. SUTHERLAND,
JOSEPH B. BRENNAN,
Counsel for Petitioner.

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[10] If evidence of the value of the obligations at the time of sale had been material to a consideration of the constitutional question, petitioner has not yet had an opportunity to adduce such evidence. Petitioner did raise his constitutional objection when respondent offered evidence in support of his affirmative defense (R. 49). The trial judge, however, excluded respondent's evidence on non-constitutional grounds (R. 49). If respondent's evidence had been admitted, petitioner would have been expected only then to offer any evidence that might be necessary to overcome the defense.